TSTCI Texas Statewide Telephone Cooperative, Inc.

May 16, 1996

RECEIVED

MAY 16 1996

FCC MAIL ROOM

Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington , D. C. 20554

DOCKET FILE COPY ORIGINAL

RE: In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, NPRM adopted April 19, 1996, Released April 19, 1996.

Office of the Secretary:

Attached are an original and sixteen (16) copies of Texas Statewide Telephone Cooperative, Inc.'s (TSTCI's) Comments in this cause.

Copies of these comments have been sent to Janice Myles of the Common Carrier Bureau and to International Transcription Services, Inc.

Please call if you have any questions regarding the attached.

Sincerely,

Gary L. Mann

Gary L. Mann
Authorized Representative

Attachments

cc: Ms. Janice Myles
Common Carrier Bureau
1919 M Street, N.W., Room 544
Washington, D.C. 20554

International Transcription Services, Inc.
2100 M Street, N.W., Suite 140
Washington, D.C. 20037

No. of Copies rec'd 0+16
List ABCDE

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

RECEIVED
MAY 16 1996
FCC MAIL ROOM

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)))	CC Docket No. 96-98

COMMENTS OF
TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.
(TSTCI)

JIM WHITEFIELD
Chairman, Regulatory Committee

GARY L. MANN
Authorized Representative
TSTCI
3721 Executive Center Dr., Suite 200
Austin, Texas 78731-1639
(512) 343-2587

May 16, 1996

Table of Contents

Table of Contents (con'd)

SUMMARY OF COMMENTS - TSTCI - May 16, 1996

The Texas Statewide Telephone Cooperative, Inc.'s (TSTCI's) comments emphasize that state commissions should be permitted to impose on those carriers not designated as incumbent local exchange companies (LECs) any of the obligations the statute imposes on the incumbent LECs.

Section 252(a)(1) of the Act refers specifically to those agreements negotiated "pursuant to" § 251 by requesting carriers. Only those agreements made under §§ 252(a) (1) and 252(b) must be filed under the Act; otherwise there is no directive to file agreements of any kind.

The carriers themselves should be allowed to determine points that are technically feasible for interconnection during negotiations. They should not be mandated by the Commission or state commissions. However, TSTCI concurs with the proposition that where interconnection is found to be technically feasible, then service providers using similar technology may be required to make such points available to requesting carriers. TSTCI strongly believes that the costs of such interconnection should be paid by the parties that cause the costs, i.e. the person that requests the connection. Any regulation that would force the incumbent to lease facilities or services to its competitors at rates below costs would be confiscatory and would violate both the U.S. Constitution and the state constitution. Collocation should be reciprocal. It is equally desirable for the incumbent LEC to be able to collocate and place its equipment in the new entrant's premises. The only technically feasible access currently available on an unbundled basis is for the loop, local switching, transport, signaling and reasonable access to databases. The unbundling of loops into sub-loops is not currently feasible and would be costly to implement.

The sub-loop connections would necessitate the design and addition of new technical interfaces at various points along the loop. These have not been identified or developed. The costs of unbundling should be paid by the new entrant.

Section 252(d)(1) does not preclude using embedded costs as a basis for pricing. Economists will generally promote some form of marginal or incremental cost because it is appropriate for pricing in a purely competitive market. The commission should not confuse costing and pricing. A reasonable contribution is one that allows the utility to earn a reasonable return on its investment. It permits one to consider the market reactions when establishing prices. Joint and common costs are real costs to the incumbent LEC.

If all prices are set equal to their marginal or incremental costs then the firm will not be able to recover its total costs which includes such common costs and corporate overhead. For local exchange telephone companies the costs mandated by regulation (those caused by readiness to serve and carrier of last resort requirements) are not marginal or incremental costs to the firm. They are nonetheless real costs to the rural telephone companies. Accordingly, LRIC should be the floor for pricing. The price must be higher to recover the embedded investments of the rural companies to insure an adequate and reasonable return.

Short run incremental costs are not appropriate for pricing, even as an interim measure for telecommunications. It would be ludicrous to require any firm to price its services equal to short run incremental costs where those costs are clearly low due to the nature of the business and the regulatory requirements. Such an approach might be characterized as confiscatory and violate the U.S. Constitution and the state constitution.

Proxies for cost based rates are unacceptable. They do not remotely represent the costs incurred by the incumbent LECs. TSTCI strongly opposes the use of the methods called total service long run incremental costs (TSLRIC). TSLRIC will not recover the full costs of providing services. TSLRIC imposes uniform prices which are contrary to accepted economic philosophy. If all prices were set at TSLRIC then the companies would not be able to recover joint or common costs; thus, such a pricing scheme is merely a prescription for going "belly up."

Although embedded costs may not be appropriate for pricing, it is absolutely essential for rural companies to recover their embedded investments from some source. That source might be a combinations of (1) pricing individual rates above LRIC to provide a contribution to the joint and common costs and (2) support from the state and federal high cost funds.

The act does not allow carriers to bypass the current interstate access charge system as alleged by some carriers.

TSTCI strongly urges the commission not to penalize the rural customers or small telephone companies by creating requirements which require large amounts of resources, and could be burdensome on the rural consumers and smaller telephone companies. Most important, the Commission should continue to provide the support mechanisms for rural companies necessary to meet the legislative mandate of maintaining universal service.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of Implementation of the	)	
Local Competition Provisions in the	)	CC Docket No. 96-98
Telecommunications Act of 1996	)	

COMMENTS OF
TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.

The Texas Statewide Telephone Cooperative, Inc. (TSTCI) files these comments in response to the Notice of Proposed Rulemaking released April 19, 1996 in this proceeding. TSTCI is an organization representing 41 local exchange telephone companies that serve approximately 200,000 access lines. The territory served by TSTCI's member companies consists primarily of rural, high-cost areas with low population. All TSTCI member companies are either cooperatives or small commercially owned companies serving fewer than 25,000 access lines. A list of the TSTCI member companies is attached as Exhibit A.

A. State commissions should be permitted to impose on those carriers not designated as incumbent LECs any of the obligations the statute imposes on the incumbent LECs.

State commissions should be permitted to impose on those carriers not designated as incumbent local exchange companies (LECs) any of the obligations the statute imposes on the incumbent LECs. In a truly competitive market all rules would be equal, but such is not the case with telecommunications in the United States; rather, the development of competition has progressed at different speeds and to different levels in each of the states. The states have unique geographic and demographic characteristics which contribute to their diversity. The availability of services and the price for those services varies among the states, and among the exchanges within states. Many residential services in rural exchanges are priced below the costs to provide the service. If collocation and unbundling of the incumbents' services would benefit competition, likewise the collocation and unbundling of the new entrants' services might also allow the incumbent to provide new service offerings promoting competition. Moreover, a disparity in bargaining power does not always favor the incumbent LEC. For example, the size and resources of the incumbent rural company will probably be much less than that of the new entrant. It follows that the duty to negotiate in good faith and to deal fairly should also be imposed upon the new entrant. The state commissions are in the best position to consider the existing situation for the companies they regulate, and for the consumers. Accordingly, the state commissions should be allowed establish rules that effectively and efficiently move toward true competition in their respective jurisdictions.

B. Agreements negotiated prior to the Telecommunications Act of 1996 should not have to be submitted to the state for approval unless they were negotiated with competitors under § 251 of the Act.

Section 252(a)(1) of the Telecommunications Act of 1996 (the Act) states that agreements negotiated pursuant to § 251 must be submitted by the incumbent to the state commission for approval under § 252(e). It also requires agreements that were negotiated before the date of the Act to be submitted. This section does not compel the incumbent to submit negotiations of any type. It refers specifically to those agreements negotiated "pursuant to" § 251 by requesting carriers. Such agreements are formed between competitors; and, these agreements are for the interconnection of competing services. TSTCI has not received a request to negotiate interconnection for the provision of basic local service. Section 252 should not be interpreted to mandate that incumbent LECs must submit existing agreements for connecting services.[1] Only those agreements made under §§ 252(a) (1) and 252(b) must be filed under the Act; otherwise there is no directive to file agreements of any kind.

Under the Joint Explanatory Statement, Congress states its intent that "[n]othing in this section should be construed as requiring any parties to renegotiate any agreement currently in existence unless the new Commission regulations under this section require such renegotiation." TSTCI urges the Commission not to adopt such a broad policy. Many EAS agreements were concluded a long time ago. A requirement that all such agreements be renegotiated would demand considerable resources of the connecting companies and would cause subsequent filings with the state commissions to reflect the changes resulting from renegotiation. Such efforts would not benefit consumers but would probably cause increases their rates.

C. The technically feasible points for interconnection should not be mandated by the Commission or the state commissions.

The carriers themselves should be allowed to determine points that are technically feasible for interconnection during negotiations. They should not be mandated by the Commission or state commissions. However, TSTCI concurs with the proposition that where interconnection is found to be technically feasible, then service providers using similar technology may be required

[1] Connecting services include such services as extended area service (EAS) or the joint provisioning of toll or 800 type services.

to make such points available to requesting carriers. This standard should apply to all service providers and not just the incumbent LECs. TSTCI also agrees that interconnection at the trunk-side and loop-side of the switch, transport facilities, tandem facilities and signal transfer points are technically feasible points for interconnection. TSTCI also recommends that the states not be allowed to designate additional points of interconnection as such proposals merely cause confusion and would cost the incumbent LECs time and resources to evaluate such proposals. Such expenses are unnecessary as the applications of equipment generally do not change based upon jurisdiction.[2]

Should the Commission adopt a uniform nation-wide standard, then it should be sufficiently flexible to allow for exceptions. Exceptions could occur where the deployment of technology permits a specific and feasible deviation for the connection. This would allow an arrangement to be negotiated between the parties which could be made available to other parties only under the same circumstances.

D. The costs of interconnection should be paid by the party that causes the costs.

TSTCI strongly believes that the costs of such interconnection should be paid by the parties that cause the costs, i.e. the person that requests the connection. True competition does not require a firm to subsidize its competitors' entry and existence in the market, nor should such costs be born by the general body of ratepayers. The service provider must be allowed to recover

[2] Interconnection standards should account for the extreme effects of weather, heat, cold and other such aspects on equipment.

its cost of providing connections to any party, whether competitors or end users. Many local residential services provided by TSTCI member companies are provided at rates below costs. Such rates were established by the state commission under the universal service obligation that the state placed upon the LEC. Further, the incumbent LECs have been required to place facilities to be ready to serve all potential customers in its franchised area. Any regulation that would force the incumbent to lease facilities or services to its competitors at rates below costs would be confiscatory and would violate both the U.S. Constitution and the state constitution.

E. Collocation should be reciprocal.

Collocation is not generally associated with competition. Collocation is analogous to forcing K-Mart to provide sales and storage space for Walmart in K-Mart stores (and also being forced to sell to Walmart at prices below its retail) so that Walmart can compete with K-Mart. The entire concept of collocation is foreign to our thinking. Since Congress has determined that telecommunications is sufficiently different, it has mandated collocation. It is only fair for collocation requirements to be reciprocal. It is equally desirable for the incumbent LEC to be able to collocate and place its equipment in the new entrant's premises. Mandating reciprocal collocation will further fair and equal competition, thus benefitting the consumer.

F. Unbundling.

The theory of unbundling is that the new entrant can lease only those elements that it wants from the incumbents allowing the new entrant to build only those facilities where to do so is economic and efficient.[3] The only technically feasible access currently available on an unbundled basis is for the loop, local switching, transport, signaling and reasonable access to databases. Access to databases should not include a level of access that would allow manipulation of information. The rules should also protect proprietary information.

1. Sub-loop unbundling is not economically or technically feasible.

The unbundling of loops into sub-loops is not currently feasible and would be costly to implement. The sub-loop connections would necessitate the design and addition of new technical interfaces at various points along the loop. These have not been identified or developed. Furthermore, where only a portion of the loop is used, the effectiveness of the remaining portion is eliminated for any practical use. If, and when, such sub-loop unbundling is to occur, then the additional cost of the new interfaces should be charged to the cost causer, i.e. the new entrant that orders the facility. The incumbent must also be able to recover the opportunity cost of such a separation of loop plant, i.e. the revenue foregone from the portion of the loop rendered useless from the unbundling.

2. The costs of unbundling should be paid by the new entrant.

TSTCI supports a uniform nation-wide approach to unbundling. This would minimize the costs of re-inventing the wheel, specifically the repetitive efforts necessary to study the technical

[3] The incumbents were never allowed such a luxury. Instead the regulators mandated that the incumbents serve all consumers in the franchised service area.

feasibility of unbundling in each of the states. TSTCI strongly recommends that any costs for unbundling be paid by the cost causer, the new entrant. Many of the new entrants in the local exchange market in Texas are large national and global corporations that have significantly greater resources than those of the incumbent rural LECs.[4] The annual advertising budget of AT&T, MCI or Sprint probably exceeds the total annual revenues of all of the TSTCI member companies combined. Surely, Congress did not intend for the small rural telephone companies, or their customers, to subsidize these global giants.

3. The price for all service and unbundled elements should be based upon cost plus a reasonable contribution.

Under §252(d)(1) of the Act the price for all interconnection and unbundled elements should be based upon cost plus a reasonable contribution. Section 252(d)(1) specifically precludes rate-of-return and rate-based proceedings from the price determination; however, it does not preclude using embedded costs as a basis for pricing. Economists will generally promote some form of marginal or incremental cost because it is appropriate for pricing in a purely competitive market. The commission should not confuse costing and pricing. They are separate and distinct functions.

a. A reasonable contribution is one that allows the utility to earn a reasonable return on its investment.

A reasonable contribution is one that allows the utility to earn a reasonable return on its

[4] The national corporations that have filed for certification to provide competitive local exchange service in Texas include AT&T, MCI, Sprint-United, MFS and GTE.

investment. It permits one to consider the market reactions when establishing prices. Joint and common costs are real costs to the incumbent LEC. The maximization of competition is not the only consideration in setting rates; the LECs deserve an opportunity to earn a reasonable return on investment. The Commission should allow the state commissions to set rates above a LRIC floor such that in total the incumbents receive sufficient revenues to cover joint and common costs and to earn a reasonable return on the firm's investment.

G. Costs for Pricing.

1. Prices set based upon a narrowly defined LRIC.

Efficient pricing exists where there is perfect competition in the entire market and all prices are equal to marginal costs.[5] This approach theoretically minimizes total costs and maximizes benefits to society.[6] A business has one primary goal, to make as much money as possible.[7] To do so, it will seek to minimize the costs of production; and, it will continue to produce, or increase production, as long as the last unit produced increases profits. The marginal cost is the cost of producing another unit. The value of that next unit is its marginal cost. In the eyes of the consumer, if this value is justified (compared to the alternatives available for the

---

[5] Samuelson, Economics 462, 634-35 (1976). This is called "first best" pricing. The prerequisites for first best are (1) efficient consumption, (2) efficient production and (3) product mix efficiency. Layard & Walters, Microeconomic Theory, 7-16, (McGraw-Hill 1978).

[6] For a more theoretical discussion of the Pareto-optimal concept see Layard & Walters, *supra,* at 7-16.

[7] 1 A. Kahn, The Economics of Regulation: Principles and Institutions 67 (1970).

consumer to spend his money) then the consumer will buy it. The total economy is efficient as products are produced in the quantities that consumers want - at prices they are willing to pay. This occurs under perfect competition at prices equal to marginal cost.[8] Long run incremental cost (LRIC) is a form of marginal cost.

There are valid social and political reasons to depart from truly efficient pricing. For example, society benefits when basic residential telephone service is provided to as many households as possible. For this to occur, basic residential telephone service may be priced below cost, particularly in the rural areas where TSTCI member companies serve. Consequently, other services, or products, may necessarily be priced above marginal cost to allow the provider of basic residential telephone service to recover its total costs and remain in business.

If all prices are set equal to their marginal or incremental costs then the firm will not be able to recover its total costs which includes such common costs and corporate overhead. For local exchange telephone companies the costs mandated by regulation (those caused by readiness to serve and carrier of last resort requirements) are not marginal or incremental costs to the firm. They are nonetheless real costs to the rural telephone companies. Accordingly, LRIC should be the floor for pricing. The price must be higher to recover the embedded investments of the rural companies to insure an adequate and reasonable return.

a. Prices based upon LRIC plus a reasonable allocation of forward looking joint and common costs.

Prices based upon LRIC plus an allocation of joint and common costs suffer some of the

[8] Layard & Walters, *supra*, at 7-16.

same frailties as those based upon fully distributed costs. The resulting prices would be useless in the market because they ignore the effects of customer demand; and, could cause rates that would be so high that the customers won't buy the service. Alternatively, the resulting prices could be so low as to not recover the total joint and common costs. There should not be a specific formula allocating joint and common costs. Instead the state commissions should be permitted to establish rates based upon LRIC plus a reasonable contribution to joint and common costs. This contribution might vary based upon a myriad of factors such as whether competition exists, value of service, allowing a reasonable return on investment and whether the public interest is served. Such an approach is necessary to insure that all joint and common costs are recovered and that the company receives an adequate return on its embedded investment.

b. Allocation of common and overhead costs using a specified allocator.

Costs are caused; they cannot be allocated. An allocation arbitrarily inflates the costs and does not reflect an appropriate measure for pricing. The Commission should separate costing from pricing. Prices based upon LRIC plus a specific allocator also suffers the same frailties of prices based upon fully distributed costs. There should not be a specific formula allocating joint and common costs. Instead the state commissions should be permitted to establish rates based upon LRIC plus a reasonable contribution to joint and common costs while considering the existence of competition and the needs of the company to earn a reasonable return on its investment.

The incumbent LECs should be permitted to recover its investment made for the purposes of readiness to serve, carrier of last resort and other universal service costs from a support mechanism such as the universal service fund.

c. Costs that vary based upon changes in demand, are incremental and not joint or common.

Costs that vary based upon changes in demand, are incremental and not joint or common. The commission presumes that joint and common costs may be minimized by identifying a substantial portion of the costs as incremental to a particular service or element. If costs are caused by the change in quantities of a service (or elements of a service) or the introduction of a new service then they were never joint or common costs in the first place. If by changing the quantity of a service you change the costs, the costs are incremental by definition. If by changing the quantities of a service, the costs do not vary, then they are joint or common.

2. Second best pricing.

Unless all prices for all products, services and substitutes are set at marginal cost (the first best solution), then the conditions for efficiency cannot be met. Accordingly, we have the theory of second best:

> If one of the standard efficiency conditions cannot be satisfied, the other efficiency conditions are no longer desirable.[9]

The problem in the telephone industry is that the local exchange telephone company may be charging rates below cost for local exchange service. At the same time, the market forces the local exchange telephone company to lower other rates to meet competition. Such a scenario

[9] Samuelson, *supra* note 5, 462; Layard & Walters, *supra* note 5, at 181.

suggests that the local exchange company will have no means to recover its fixed or unavoidable costs without a second best pricing solution, such as Ramsey pricing or some form of external support. Additionally, price support mechanisms are needed as long as the federal and state commissions continue programs such as Lifeline and Relay Texas; and, more importantly, continue the universal service mandate of Congress and the state legislature.

a. Ramsey Pricing

Ramsey Pricing, the inverse elasticity rule, is a second best deviation from marginal costs. The rule states that when a pricing constraint is present, the socially optimal price will exceed marginal cost by an amount inversely proportional to its own price elasticity of demand.[10]

This means that if one group of customers is characterized by price elastic demand and another group is characterized by price inelastic demand, the goals of marginal cost pricing can be furthered by charging the customers with elastic demand rates based on marginal cost.[11] The resulting revenue deficiency then can be made up by charging the customers with inelastic demand rates in excess of marginal cost. A problem faced by the rate-maker is identifying the elasticities of demand of the various products or services.

[10] Bonbright, Danielsen & Kamerschen, Principles of Public Utility Rates, 132-34 (Public Utilities Reports, Inc. 2d Ed. 1988). Bonbright criticizes Ramsey pricing, but his criticisms could apply equally to any attempt at real-world marginal cost pricing. *Id.* at pp. 533-42.

[11] Price elasticity is the responsiveness of a service's sales volume to changes in its price. If the percentage change in sales exceed the percentage change in price, then the demand for the service is said to be elastic. Otherwise, the demand for that service is inelastic.

Basic residential local exchange telephone service is an example of a service with relatively inelastic demand; but, it is also the service that has traditionally been priced below cost. Under the Act, local service has become competitive. Thus, the Ramsey approach may no longer be viable as a second best solution. A possible alternative would be to target specific customer classes, or geographically high cost areas, to receive price support, allowing the remainder of local services to be considered for reasonable increases in price.

3. Short run incremental costs are not appropriate for pricing.

Short run incremental costs are not appropriate for pricing, even as an interim measure for telecommunications. Telephone plant is placed to handle forecasted demand over a period of time. For conduit, cable supporting structures, cable and fiber that period of time may be five to 30 years. For central office switches the period may be from ten to 30 years. Additions in a central office may be scheduled every other year. Although technology and demand has an effect on the timing of replacement and reinforcement of plant, generally the period of time is fairly long as compared to other technologies prevalent today. Much of the telephone plant of the small rural companies has been placed to comply with the directive to be ready to serve all consumers within a franchised area. Plant has been placed due to a regulatory requirement to be the carrier of last resort. Accordingly, when looking at specific types of facilities and equipment there are different amounts available for planned use in the future. Some of the facilites and equipment may be spare. The short run incremental cost of much of the facilities and equipment approaches zero.

It would be ludicrous to require any firm to price its services equal to short run incremental costs where those costs are clearly low due to the nature of the business and the regulatory requirements. Such an approach might be characterized as confiscatory and violate both the U.S. Constitution and the Texas constitution.

4. Proxies do not adequately represent economic costs incurred by the incumbent LECs.

Proxies for cost based rates are unacceptable. They do not remotely represent the costs incurred by the incumbent LECs. Southwestern Bell Telephone Co. analyzed the Benchmark Cost model supported by MCI, NYNEX, Sprint and U.S. West. Southwestern Bell's extensive analysis demonstrates that the model does not provide a reasonable comparison to actual costs by study area or by wire center.[12]

5. TSLRIC is not appropriate for costing or pricing.

TSLRIC is not appropriate for costing or pricing telecommunications. TSTCI strongly opposes the use of the methods called total service long run incremental costs (TSLRIC). TSLRIC will not recover the full costs of providing services. TSLRIC imposes uniform prices which are contrary to accepted economic philosophy. If all prices were set at TSLRIC then the companies would not be able to recover joint or common costs; thus, such a pricing scheme is merely a prescription for going "belly up." TSLRIC cannot serve as a basis for measuring universal service subsidy as it ignores embedded investments required by regulators to fulfill

[12] See Comments of Southwestern Bell Telephone Company in CC Docket 96-45 dated April 12, 1996 at pages 14-16 and Attachment 5 to its comments.

carrier of last resort obligations. Furthermore, TSLRIC is not described in any economic literature and is not accepted as a legitimate form of marginal or incremental cost.

6. Fully embedded cost pricing found under Part 64 is not appropriate for pricing services or facilities in a competitive market.

Fully embedded cost pricing found under Part 64 is not appropriate for pricing services or facilities in a competitive market. Fully distributed cost pricing is an attempt to preclude cross-subsidization. To achieve subsidy free pricing the cost allocation rules under Part 64 of the FCC Rules and Regulations were developed.[13] The rules require common costs to be allocated using a variety of ad hoc methods. Under Part 64 the rate for a service must cover its fully distributed cost. Such methods insure that prices are subsidy-free; however, such prices are useless in the market because they ignore customer demand. The results of Part 64 methods could be rates so high that the customers may not be able to pay the price.[14] Although embedded costs may not be appropriate for pricing, it is absolutely essential for rural companies to recover their embedded investments from some source. That source might be a combinations of (1) pricing individual rates above LRIC to provide a contribution to the joint and common costs and (2) support from the state and federal high cost funds.

---

[13] Larson, Cost Allocations, Predation, and Cross-Subsidies in Telecommunications, J. Corp. L. 394 (1988).

[14] *Id.* at 395.

7. **Residual ratemaking**

One of the purposes of rate regulation is to assure that the regulated firm earns sufficient revenues to remain in business. Traditionally, the utility commissions have applied rate-of-return regulation to telephone companies. Under this concept, the state commissions decide what revenues the companies should be allowed to take in, then they set rates for services to yield these totals.[15]

Residual ratemaking is the process which has historically been used to set rates for local services. Rates are first determined for all competitive, vertical and discretionary services. Next, the amount of revenues expected to be generated from the competitive, vertical and discretionary services is calculated. This amount is then subtracted from the total revenues that the commission has decided the company should be permitted to earn. The remainder is called the residual. The residual must be obtained from the remaining services, traditionally the local services category. The final step is the process of dividing the residual by the quantity of local services to determine the price of local services. This approach is no longer valid where local services are competitive.

H. **Continued enforcement of exchange access.**

The act does not allow carriers to bypass the current interstate access charge system as alleged by some carriers. This should be clearly enunciated in the FCC's rules. Sections 251(b) and (c) and 252 deal exclusively with local exchange services and 251(i) specifically preserves section 201 of the Communications Act which grants the Commission the authority to establish

[15] Kahn, *supra* note 7, at 26.

interstate access charges. Moreover, 251(g) preserves all of the Commission and consent decree restrictions and obligations regarding access to interexchange carriers including compensation If Congress had intended to replace the current interstate access charge system, 251(g) would have been unnecessary.

I. Conclusion.

The pursuit of universal service should affect pricing of all telecommunications services, not just LEC services, and not just basic local exchange service. Consider, for example, the cross-price elasticity between local exchange and long distance service. A change in rates of either service affects the demand for the other.

Notwithstanding this belief, the Texas legislature has mandated universal service.[16] The legislature has also required the local exchange telephone company to serve all consumers in the certificated exchange.[17] Such directives should not be taken lightly; moreover, it is reasonable to assume that such social and political policies will continue in the foreseeable future.

In the past, the lucrative profits from long distance rates and other discretionary services provided the necessary revenues to keep basic local exchange service affordable in rural areas. The rural

[16] It is the policy of this state to protect the public interest in having adequate and efficient telecommunications service available to all citizens of the state at just, fair, and reasonable rates. Public Utility Regulatory Act (PURA), Tex. Rev. Civ. Stat. Ann. art. 1446c §3.051(a) (Vernon 1993).

[17] The holder of any certificate of public convenience and necessity shall "... render continuous and adequate service within the area or areas..... [and] has provider of last resort obligations." *Id.* §3.258.

areas are sparsely populated and relatively costly to serve, unlike the large metropolitan areas. For example, it costs the same to bury a large feeder cable (designed to serve two-thousand customers) as it does to bury a small twenty-five pair cable. Buried cable is one of the major costs of feeder plant.

Additionally, states should be given flexibility to insure that the resale policies are consistent with universal service goals and to not undermine other state public policy goals. For example the states might restrict the resale of local residence service as long as such services are provided below costs. The telephone companies should not be required to offer for resale services at prices below costs.

After the divestiture of the Bell System, the support from prosperous long distance services disappeared as the interexchange carriers took over the most favorable long distance routes. To replace this loss, other support mechanisms evolved, such as carrier common line charges, long term support and the universal service fund. It is imperative that this support continue for the rural areas to receive basic telephone service - and to permit the rural populace to participate in the technological advances of the information age.

"[T]he single most widely accepted rule for the governance of the regulated industries is regulate them in such a way as to produce the same results as would be produced by effective competition...."[18] The overriding criterion for the commission to use in pricing LEC services should be the public interest. Additional considerations for pricing are to insure the economic efficiency in the investment of telephone plant and provisioning of telecommunications services; to

[18] Kahn, *supra* note 7 at 17.